

# Corpsec Hotline

August 01, 2013

## RELAXATION OF FDI NORMS ON THE ANVIL: A BOOSTER PROVIDED!

The Ministry of Commerce and Industry of the Government of India ("**Ministry**") has recently released a press release ("**Press Release**")<sup>1</sup> disclosing the decisions taken at a meeting chaired by the Prime Minister of India proposing to ease foreign direct investment ("**FDI**") norms in certain specific sectors under the consolidated FDI policy ("**FDI Policy**"), a last version of which was released by the Department of Industrial Policy and Promotion on April 5, 2013. The Press Release was issued based on the decisions taken by the Cabinet Committee on Economic Affairs, headed by the Prime Minister of India. The Press Release indicates that the FDI caps and investment routes for certain important sectors are proposed to be revised but the Press Release does not specify the relaxation of any conditions, if there are any, for those specified sectors.

This decision of the Ministry comes in the backdrop of a declining economic climate, including deteriorating growth rates, high inflation, and high current account deficits. The decision of the Government of India to ease the FDI caps and routes in certain specific sectors appears to be an attempt to manage the downtrend in the economy currently. The decisions taken by the Government are based on recommendations of the Mayaram Committee that was formed for this specific purpose.

## CHANGES PROPOSE

The following table provides a comparative analysis of the position proposed by the Ministry under the Press Release with the current status under the extant FDI Policy:

S. No.	Sector	Current Position under the FDI Policy		Proposal under the Press Release	
		Sectoral Cap	Route	Sectoral Cap	Route
1	Commodity Exchanges	49% (includes FDI and Foreign Institutional Investment ("FII")) [Investment by registered FII under the Portfolio Investment Scheme ("PIS") will be limited to 23% and investment under the FDI Scheme limited to 26%]	Government Approval (For FDI)	49%	Automatic
2	Power Exchanges	49% (FDI and FII)	Government Approval (For FDI)	49%	Automatic
3	Stock Exchanges, Depositories, Corporation	49% (FDI and FII) [FDI limit of 26% and FII limit of 23% of paid up capital]	Government Approval (For FDI)	49%	Automatic
4	Asset Reconstruction Companies (" <b>ARC</b> ")	74% of paid up capital of the ARC (FDI and FII)	Government Approval	Up to 49% 49% to 100%	Automatic Government Approval
5	Single brand retail trading	100%	Government Approval	Up to 49% 49% to 100%	Automatic Government Approval
6	Defence Production	26%	Government Approval (also subject to industrial license under the Industries (Development and Regulation) Act, 1951	26% Beyond 26%	Government Approval Cabinet Committee on Security (" <b>CCS</b> ") may approve proposals on case to case basis beyond 26% which are likely to result in access to modern and state of the art technology in the country.

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7	Basic and Cellular Services etc.	74%	Automatic up to 49% and Government Approval beyond 49% and up to 74%	Up to 49%	Automatic
8	Petroleum and Natural Gas and refining	49%	Government Approval	49%	Automatic
9	Credit Information Companies	49% (FDI and FII)	Government Approval	74%	Automatic
10	Courier Services	100%	Government Approval	100%	Automatic

## ANALYSIS OF PROPOSED CHANGES TO CERTAIN KEY SECTORS

1. **Single Brand Retail Trading ("SBRT")** - The Press Release has proposed a welcome relaxation of FDI into SBRT by allowing FDI up to 49% under the automatic route. FDI in SBRT sector was initially relaxed in January 2012 and then subsequently certain ambiguities were clarified in September 2012. For details thereof, please refer to our hotlines titled **100% FOREIGN DIRECT INVESTMENT IN SINGLE BRAND RETAIL ALLOWED!!!** and **INDIA BREAKS THE FDI SHACKLES: MULTI BRAND RETAIL TRADING AND OTHER SECTORS LIBERALIZED**.

This change may quicken the process for a lot of brands who are willing to operate through the joint venture structure in this sector with a local resident holding 51% or more of the investment in the Indian retail entity that is proposed to undertake SBRT. The Press Release does not currently indicate whether the prevalent conditions applicable for FDI in SBRT sector, as stipulated under the FDI Policy, shall continue to apply for FDI up to 49% which is now proposed to be under the automatic route.

2. **Defence Sector** - Being a highly sensitive sector, the Press Release has stated that the current 26% threshold for FDI in defence sector (under the Government Approval route) shall continue to prevail; however, proposals for higher FDI (more than 26%) shall be considered and approved by the CCS on a case to case basis. For allowing FDI above 26% in this sector, the Press Release stipulates that the CCS shall take into consideration whether such investment brings along with it access to modern and state of the art technology in the country or not.

The Press Release does not contemplate, and the final notification shall clarify, whether the DIPP is proposing any further relaxation in the conditions that are currently attached with this sector as contained in the FDI Policy.

3. **Telecom Sector** - The proposed revision of the sectoral cap in the telecom sector has been one of the most awaited decisions regarding FDI into India. As is the present scenario under the FDI Policy, FDI upto 49% is proposed to continue to be under the automatic route, however, the existing 74% maximum cap under the Government Approval route (above 49% to 74%) is proposed to be raised to 100%.

This proposed change will give an impetus to all the global telecom giants as well as the prevailing structures in this sector to approach the Indian regulators to seek their approval for allowing them to entirely own the Indian entity that shall undertake operations in this sector and eliminate the need to have an Indian partner for their structure to operate.

4. **Asset Reconstruction Companies** - The FDI Policy provides that the maximum limit for FDI in ARCs is up to 74% of the paid up capital of the ARC, comprising of both FDI and FII investments. The total shareholding of an individual FII is not allowed to exceed 10% of the total paid-up capital of the ARC. Though the Press Release has not clarified the breakup of the investment between FDI and FII, under the revised sectoral caps proposed; however, it has been proposed that FDI up to 49% shall be under the automatic route and above 49% till 100% shall be under the Government Approval route.

Proposed change under the Press Release contemplates allowing ARCs to be wholly owned by foreign residents, should an approval be given by the Foreign Investment Promotion Board (FIPB) to own 100% of the shareholding in the ARC.

5. **Power Exchanges, Commodity Exchanges, Stock Exchanges, Depositories and Clearing Corporations** - Possibly, in a bid to allow more participation by global exchanges, the Press Release has proposed relaxation of upto 49% of FDI into power exchanges, commodity exchanges, stock exchanges, depositories and clearing corporations under the automatic route. Although the current threshold for these sectors is limited to 49%, but the same comprises of FII and FDI routes, of which, the FDI route is subject to Government approval. Although, if there is any change in the break-up of the 49% limit, the same is not spelt out in the Press Release; however, the Press Release contemplates automatic route for the cap of 49% and thus eliminating the need to seek any approval for such limit of investment.

Whether FII investment for these sectors forms part of this 49% cap or whether the same is over and above the FDI limit is not clear at this moment and more clarity on the same shall be spelt out in the final notification to be issued by the regulator.

6. **Courier services** - In a welcome move, the Press Release has proposed to open up the sector of courier services by allowing 100% FDI in the sector under the automatic route from the current position being under the Government Approval route. This move is expected to be beneficial, especially for opening up of the logistics sector in India.

## CONCLUSION

While the Government has decided to open up the abovementioned sectors as a mechanism for combatting the declining economic climate, the Government has attempted to steer clear of certain other key sectors such as civil

aviation and pharmaceutical.

The Government has also refrained from taking any measures to liberalize the FDI regime with respect to multi brand retail trading ("MBRT"). While this sector had opened up close to a year ago, global retail majors have contended that the associated conditions are extremely onerous and as a consequence not a single application has been made till date to the DIPP for investment under the MBRT sector. Even though the DIPP recently had issued certain clarifications on the FDI in MBRT sector, most of the clarifications are viewed more of a blocker rather than an opener. For further details, please refer to our hotline → [CLARIFICATIONS ON FDI IN MULTI BRAND RETAIL TRADING: AS RESTRICTIVE AS IT MAY GET](#).

The relaxations proposed in the Press Release come as a timely breather and the stipulated sectors should witness certain action once the official notifications are issued by the DIPP. Although, the Press Release has limited itself to modification in the caps and/or the investment routes applicable for the respective sectors, it has not spelt out the procedural implications and modifications to the applicable conditions, if any; thus, leaving the devil in the detail.

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You can direct your queries or comments to the authors

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<sup>1</sup> <http://pib.nic.in/newsite/erelease.aspx?relid=97252>

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